Proposal for Allowed Loop Plant Capital Expenditures

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Introduction/Overview

- Efforts to Limit Growth in USF Fund Size Can Have Unintended Consequences if Not Carefully Designed
  - Relying solely on adjusting the National Average Cost Per Loop in a capped HCL mechanism could prompt a “Race to the Top”
  - Adjusting HCL reimbursement percentages would not address the core issue and would skew distribution toward companies who likely need the support less

Introduction/Overview

- Need to Better Ensure Individual Companies that Draw from the USF are Treated Fairly
  - Constrain any “race to the top”
  - Manage future pace of investment-related growth in USF
  - Tie recovery of future investment to replacement of depreciated plant (*i.e.*, where there is the least broadband or a need for upgrades)
- Promotes Smart and Carefully Managed Investment to the Benefit of All
  - Will stimulate targeted broadband deployments and upgrades for consumers where needed most
  - Will help lenders, private investors, and business planners discern whether and to what degree to finance/undertake future broadband deployments

Determining Allowed Capital Expenditure

Step 1. Determine Current Loop Investment

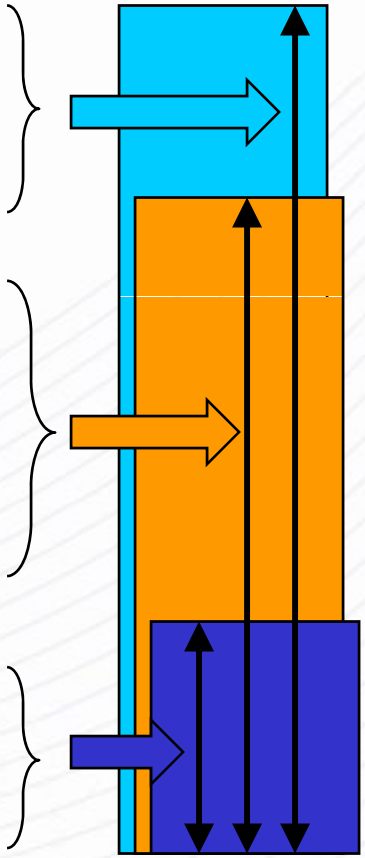
- Based on LEC existing study area
- Total Loop Investment (from books) adjusted for Inflation

Step 2. Determine Future Allowable Investment (FAI)

- Assumes LEC can replace facilities that are beyond their end of life (fully depreciated)
- Sets the total "budget" allowed for LEC investment by reference to what needs replacement
- Current Loop Investment (Step 1) times ratio of depreciated loop investment to loop investment from books

Step 3. Determine Current Year Allowable Investment

- Determine portion of FAI that can be replaced in current year
- Goal is to spread investment over time
- "Allowable" means potentially recoverable in current year – carriers could choose to invest more as needed, but would go without support in that year (and/or going forward if there is no available "budget" for such investment in subsequent years)



Step 1: Determine Current Loop Investment (Tot INV)

- Determine Booked Local Loop Investment for each RoR-Regulated Company (RLEC)
  - Cat. 1/Cat. 4.13 – Exchange Line Cable & Wire Facilities and Equipment (Excluding Wideband)
  - Cat. 2/Cat. 4.11 – Wideband and Exchange Trunk Cable & Wire Facilities and Equipment
- Determine "current" loop investment by adjusting "booked" value for inflation
  - Bring booked investment forward to current dollars
  - This is the total study area investment (Tot INV)

Step 2: Determine Future Allowable Investment (FAI)

- "Sets the budget" for each RLEC study area
- Calculate the ratio of (a) local loop accumulated depreciation to (b) booked local loop investment for each RLEC study area

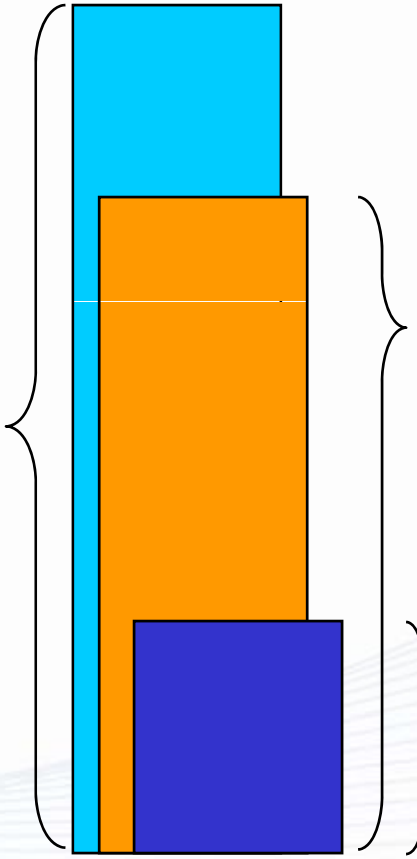
$$\text{FAI} = \left(\frac{a}{b}\right) * (\text{Tot INV})$$

- Effectively allows only replacement of depreciated plant – helps control growth in USF and ensure funds go where needed most
  - Depreciated plant has reached end of life
  - Need for "safety valve" and greenfield exemptions

Step 3: Spread FAI over Investment Period

- This “sets the pace” at which the “budget” can be spent
  - Minimizes/paces the demand on USF
- Proposed Method for Spreading FAI over Investment Period to Determine Current Year Allowable Investment
  - Loop plant investment amount eligible for USF support in any given year would be the lesser of: (a) 20% Total INV or (b) FAI
  - Investments in excess of those eligible for USF in current year may be rolled over by RLEC to next year for potential USF support based upon same analysis

Recap of Allowed Loop Investment



Total Loop Investment (Tot INV)
(Inflation Adjusted)

Future Allowable Investment (FAI)
(Portion of "Tot INV" that is Fully Depreciated)

Current Year Allowable Investment
(Lessor of 20% Total Loop Investment or FAI)

Other Considerations

- Calculations repeated each year to determine loop plant investment amount eligible for USF in that year
- Small Company Investments
  - Inefficient to spread over 5 years for very small companies
  - If a LEC's Total INV is less than $4M, the full amount should be allowed and supported in a given year
- Normal maintenance and routine upgrades
  - 5% of Total INV should be allowed regardless of FAI

Other Considerations (cont'd)

- Greenfield Builds
  - Greenfield builds should be allowed in addition to any FAI or maintenance and routine upgrades – no plant to depreciate associated with such areas
- "Safety Valve" Waiver Process
  - Streamlined process needed to accommodate:
    - Unforeseen technology/equipment/materials costs
    - Other special circumstances associated with deployments in remote, hard-to-serve areas
    - Local changes not reflected in booked investments

Example 1 – Company with Mostly Depreciated Plant

- Estimate Total Investment
  - Total Loop Plant (from books) = $87.6M
  - Apply Inflation Factor = $100M (Tot INV)
- Future Allowable Investment
  - Total Loop Depreciation = $75.2M
  - Depreciation Ratio = $75.2M/$87.6M = 0.858
  - $100M*0.858 = $85.8M
  - $85.8M = Future Allowable Investment
- Spread Future Allowable Inv over Inv Period
  - Maximum of $20M can be invested in current year

    (20% of $100M is maximum investment for current year)

Example 2 – Company with Little Depreciated Plant

- Estimate Total Investment
  - Total Loop Plant (from books) = $65.2M
  - Apply Inflation Factor = $70M (Tot INV)
- Future Allowable Investment
  - Total Loop Depreciation = $9.3M
  - Depreciation Ratio = $9.3M/$65.2M = 0.14
  - $70M*0.14 = $9.8M
  - $9.8M = Future Allowable Investment
- Spread Future Allowable Inv over Inv Period
  - Maximum of $9.8M can be invested in current year (20% of $70M is greater than $9.8M)

Example 3 – Small Company

- Estimate Total Investment
  - Total Loop Plant (from books) = $4.0M
  - Apply Inflation Factor = $4.5M (Tot INV)
- Future Allowable Investment
  - Total Loop Depreciation = $2.5M
  - Depreciation Ratio = $2.5M/$4.0M = 0.625
  - $4.5M*0.625 = $2.8M
  - $2.8M = Future Allowable Investment
- Spread Future Allowable Inv over Inv Period
  - Maximum of $2.8M can be invested in current year
    - (20% of $4.5M is $900K and $2.8M is less than $4M minimum)

Thank you.